October 29, 2020

TO: Texas House Committee on Licensing & Administrative Procedures
FROM: Wine Institute
RE: Interim Charge #3, "Control Labels"

Dear Chairman King and Members of the Licensing & Administrative Procedures Committee,

Wine Institute is a trade organization comprised of about 1000 California wineries and affiliated businesses. Wine Institute's mission is to advocate for public policy that enhances wineries' ability to responsibly and efficiently produce, promote, sell, and enjoy wine. I am writing to you about the Texas Speaker's interim charge for your committee that states:

> *3. Examine "control label" products and their impact on the three-tier system and alcoholic beverage industry in the state. Make recommendations to regulate control label products in a way that promotes economic growth, benefits the consumer, and stabilizes the three-tier system.*

While Wine Institute takes no position on the manufacture or distribution of "control label" products, the retail sale of those products can create a problem for Wine Institute members, small alcoholic beverage retailers, and the public at large. Large, multistate retail stores that sell both wine and spirits in Texas often use recognized brands of wines and spirits as loss leaders. In other words, these nationally recognized wine and spirit brands are marked down below the cost the retailer paid the wholesaler for them in order to bring customers in the store, only to promote and sell at much higher margin the retailer's own "private" or "control labels." The effect of using any alcoholic beverage, not just wine, as a loss leader has a reverberating effect on the State of Texas.

First, members of Wine Institute work years and spend millions of dollars to develop, market, promote, and sell their wine brands. This includes reasearching and deciding the perfect price point to sell their products to wholesalers in each state. Wholesalers, with the winery's input, recommend a price point to the retailers to whom the wholesalers sell. Like any business, the idea is to create profit for the manufacturer, the distributor (wholesaler), and the retailer. It can be a delicate balance between the three tiers of the alcoholic beverage industry to ensure that all three tiers sell the wine at the right price for each tier and for the customer. Using wine and other alcoholic beverages as loss leaders completely upsets that delicate balance, destabilizes the three-tier system, and it wholly undermines the time, money, and effort wineries expend to set up that balance. Most importantly to wineries, using their wine as a loss leader inevitably undermines the value of their wine.

Second, control labels realistically can only be obtained and promoted by large retailers, therefore smaller retailers lose out. Only large retailers have both the capacity and the capability to contract with and pay alcoholic beverage manufacturers to produce their control label beverages. Smaller businesses do not have the financial strength to obtain their own control labeled beverages. In order to survive, smaller businesses rely solely on the margins of the brands they buy from wholesalers and distributors and sell to the public. Compunding the issue, these small businesses do not have the capacity to mark down nationally-recognized brand names below the cost they paid for them in order to use those brands as loss leaders. And finally, while smaller retailers could purchase from a wholesaler another retailer's control label wine or spirit, it is quite possible the retailer's control label wines and spirits are unavailable because that retailer who owns the control label purchased all of the product. If a retailer's control label wine or spirit is unavailable for other retailers to purchase, then that wine or spirit becomes de facto exclusive, something prohibited by Texas law. All in all, selling wine and spirits below the cost the retailer paid the wholesaler for it hurts small businesses and therefore is destructive to economic growth in Texas.

Third, as you know, Texas state law prohibits corporations from obtaining a package store license. Thus, large corporate retailers do not have package store permits in Texas. However, state law does not prohibit large, multistate, *privately* owned businesses from having package store licenses. These types of businesses have the financial ability smaller package stores cannot have. To start, with presence in many states, their profit margins can be offset by their other stores. Also, with a portfolio of stores, they have more of a financial capacity to contract with large wine and spirit producers to make controlled label wine and spirits to sell in all of their stores. With the production of these controlled labels, they have more control over not just what goes into the bottle, but how much they spend on the wine or spirit produced. Then, these stores can mark up the bottles to create such a high margin that they will then have the ability to use nationally-recognized brands as loss leaders, bringing customers in their doors because they believe that the brand is worth less than it actually is. This unquestionably disparages the winery's brand across the marketplace, not only in the store offering the sale below cost.

Additionally, marking down a controlled substance like alcohol below what the retailer paid the wholesaler for it can contribute to more consumption by the consumer. While Wine Institute members wish to sell their wine, they hope for and encourage drinking in moderation. Using alcohol as a loss leader can promote over-consumption, something that is detrimental to both the consumer and the State of Texas.

Finally, it is worth noting that with more states considering changing their laws to allow retailers to ship wine (and perhaps spirits) directly to consumers, more control-labelled wines from large retailers would enter the market. Without a law prohibiting sales below cost, a retailer's ability to use nationally-recognized brands as loss leaders would continue to both undermine a winery's brand and further damage small alcoholic beverage retailers.

A winery's grapes and wine becomes like a member of the family. When someone undermines that family member, the winery, like any family, seeks resolution. **Prohibiting the sale of alcoholic beverages below cost is that resolution.** For an example of legislation prohibiting the sale of alcoholic beverages below cost, please see House Bill 2165 by Rep. Ana Hernandez, passed both by this House Committee on Licensing and Administrative Procedures and by the Texas House of Representatives.

Thank you for the opportunity to submit Wine Institute's comments on interim charge #3. I am happy to discuss my comments further or answer any questions should they arise. I can be reached at trudd@wineinstitute.org or at (512) 293-0247.

Many thanks,

Tyler Rudd
Central States Counsel